

# THE RAILROAD WEEK IN REVIEW

## January 3, 2014

*"Northern Securities hadn't done anything wrong, but it might and that was enough." Author Larry Haeg in Harriman vs. Hill, page 276*

**Genesee & Wyoming to acquire DM&E west end from CP.** In a joint announcement after the close Friday, the companies said GWR will pay CP \$210 million for some 660 miles of this ex-CNW track running west from Tracy, Minn. and across South Dakota to Rapid City. There the line splits, with one branch heading north to Colony, Wyoming and another branch south to Dakota Jct. and Chadron, Nebraska. A short branch from Dakota Jct. to the Crawford junction with BNSF is currently leased to the Nebraska Northwestern Railroad.

This last was the way CP had originally hoped to use for its PRB build-in when it bought the DM&E five years ago, and it's doubtful those plans will ever be resurrected. The north line out of Rapid City is where the bentonite comes from and it's about half the width of Montana away from the southern edge of the Bakken shale-oil fields. Though 52,000 loads on 660 miles of railroad fails my Rule of 100 test, my money is on GWR finding enough synergies of scale to (a) attract more carloads per mile and (b) take out enough overhead cost to make the numbers work.

The asset sale is expected to close by mid-2014, subject to various approvals. The new railroad will be named the Rapid City, Pierre & Eastern Railroad with a staff of about 180 souls, most of whom are already on the railroad. CP will continue to own and operate approximately 1,900 miles of former DM&E track following the sale and is expected to take a \$240 million net-after-tax write-down in the 4Q2013 period.

The transaction is cash positive for CP and the sale will not have a material effect on anticipated future earnings. For G&W, it is expected the transaction will generate annual revenues of approximately \$65 million and be immediately accretive to book and cash earnings per share in 2014. The sale will undoubtedly benefit CP in its ongoing transformation to make its network stronger for its entire customer base. Next stop: the D&H in 2Q2014.

**Canadian National's weekly Railroad Performance Reports for Nov 1 through Dec 27** would suggest Old Man Winter has gotten ahead of CN. Railroad-owned freight cars on line with non-CN marks are up nine percent; system average train speed is down 17 percent. Average terminal dwell time is up 55 percent, with Winnipeg more than doubled (up 114 percent) to 46 hours from 22 hours and Vaughan (Toronto) up 90 percent to 32 hours from 17 hours.

Channel checks tell me (a) the cold weather impacts brake-pipe pressure so the usual 120-car train start becomes two 60-car train-starts, requiring twice as many locatives and crews, gobbling

scarce mainline track space in the bargain. Which supports (b), what I'm hearing about VIA's *Canadien* between Vancouver and Toronto, running as much as a day late at the end terminals.

Next week I will see for myself. I'm riding the eastbound *Canadien* Jan 10-14 (and possibly the 15th, depending) with about sixty active and retired senior railroad managers, pundits, consultants and Friends of the Railroad. Last year's trip was described as "ugly," and, based on the above, I'm expecting Ugly again. With any luck, though, such delays as there are will happen at night, letting us see even more of the railroad. I'm told the wine list and food service is superb, so an extra day at no added cost will be a great bargain.

**You may recall** a few years ago Canadian Pacific had a particularly bad winter while CN got off relatively easy. Comparing the same periods — the week ending Nov 1 *vs.* the week ending Dec 27 — CP does a little better. Foreign freight cars are up five percent to CN's nine percent. CP's average system train speed is recovering more quickly than CN's; see chart at end.

System terminal dwell is up 51 percent, but still just 11 hours *vs.* CN's 23 hours, indicating better yard through-put. CP's worst yards for dwell increase are Toronto, up 90 percent to 15 hours, and Moose Jaw, up 84 percent to 14 hours. Chicago is the only place where cars weren't getting out of town in 24 hours (29 hours). That said, one must look at all these metrics in terms of total cars on line. For the Dec 27 week, CP had 81,318 cars on line to CN's 130,453 — forty percent less.

**Norfolk Southern President Jim Squires turned in a fine performance** at the December 4 Credit-Suisse Global Industrials Conference, slides [here](#). Right out of the box you can see how the commodity mix — coal, intermodal, merchandise — is shifting. You can see how NS has shifted T&E assets from coal to the other two on slide 4. Fewer train-starts handling more volume means lower avoidable operating expense per GTM, slide 5. Now jump to slide 9 for the merch carload sector Business Outlook. You'll note most of the commentary goes to the commodity groups that short lines rely on: frack sand and drilling pipe, LPG, plastics, grains, construction materials. Trends in Q4 are also encouraging. Squires says ag volume is up ten percent, due mainly to the favorable corn and soybean crop. The Metals and Construction group is up six percent on more construction materials and new terminals for sand and gravel. Lumber is up two points year-over-year on the putative housing recovery while paper sees somewhat weaker demand.

Service metrics — such as we get in the slide set — seem to be heading in the right direction, meaning NS can handle the increased auto and crude oil flows within the present operating footprint. Squires says 87 percent of the NS corridor (slide 20) for crude oil off both CP and BNSF is operating at less than 80 percent of capacity; the remaining 13 percent is below 85 percent of capacity. On the merch front, the drive to right-size network operations to fit the available vols lets NS target some \$100 million in productivity gains.

Clearly, NS is redeploying assets once dedicated to coal over to intermodal and merchandise to good effect. The challenge remains to get the high-cost, first-mile, last-mile aspects of the single-

carload franchise under control. I've written before that the R-1 report for NS shows an asset-intensive business with many more "way freight" train starts than its arch-competitor CSX for about the same revenue-unit numbers and route mileage.

One solution is to right-size the network itself, not just network operations, by eliminating train-starts and route-mileage where the traffic base fails to meet re-investable returns. Close more yards, shed more marginal branches, combine shops and shop forces, and shrink the administrative footprint. Then we'll see how many points come out of the OR how fast.

**What goes around, comes around Dept.** The initial quote is in the context of *Northern Securities Company v. The United States of America*, argued before the Supreme Court in December, 1903. At issue was whether James J. Hill, et. al. could create an operating company owning three railroads: the Northern Pacific, the Burlington and the Great Northern.

As Larry Haeg recounts in his superb history, Associate Justice John Harlan said, "The mere existence of such a combination... constitutes a menace to, and a restraint upon, that freedom of Commerce which Congress intended to recognize and protect." And, "The public needs to be protected against the exactions for corporations wielding the power which attends the possession of unlimited capital."

*Harriman vs. Hill* drills down into *Northern Securities* and does so with meticulous detail, from the description of Hill's St. Paul residence and family life to the interplay between and among UP's Edward Harriman, the Rockefellers, and J.P. Morgan. And whereas Ron Chernow's Morgan biography and Albro Martin's Hill biography only touched on *Northern Securities*, Haeg has given us the full story, even down to court document excerpts.

For contemporary students of the railroad industry, I feel the meat of the book is in the Supreme Court arguments, showing how the case affected government and railroad interactions for 80 years. The ICC got the power to set rates just two years after *Northern*; the Mann-Elkins Act four years later "forbade rate discrimination between long and short hauls" and got into the price control business. Then came the World War I nationalization of the rails and the 1920 Transportation Act forbidding mergers. And so on, right up to the 1980 Staggers Act.

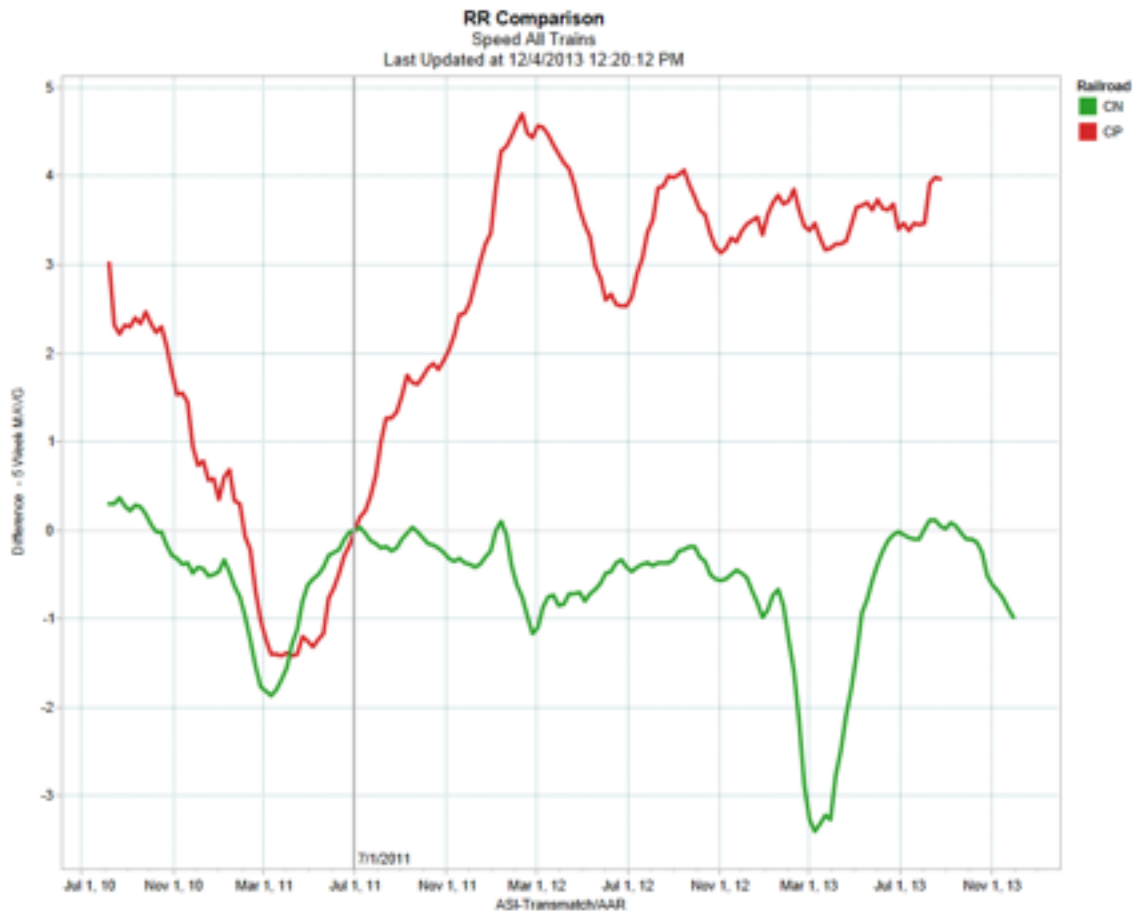
Stepping back, one can see today's activist politicians seeking to "do something" to protect the public from the black events that might happen if the rails aren't told how to behave. As the government said in *Northern Securities*, it acted to prevent something illegal happening, even though nothing illegal had in fact taken place.

Haeg points out the government's case wasn't all that solid, and it took none other than Justice Oliver Wendell Holmes to say so. "The courageous, eloquent dissent deprived [President Teddy] Roosevelt and [Attorney General Philander] Knox of a decisive victory, and narrowed the application of the verdict... Roosevelt always insisted he wanted to use the power of the

government to punish corporations for their conduct not their size. That is why, in his dissent, Holmes referred cynically to Roosevelt's lawsuit was 'an accident of overwhelming interest.'

Nearly 70 years later, Justice Warren Burger, "son of a Northern Pacific Freight conductor," announced the court's decision to uphold the merger of the NP, GN and the Q. And in November 2009, Warren Buffett's Berkshire-Hathaway bought the BNSF. It was (Haeg again) "a bet on what drives the economy: the capitalist, free enterprise vision" of Hill, Harriman, Schiff and Morgan. And so it is that what goes around, comes around. Thanks, Larry.

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The trend of Difference in Moving Average of Avg. Value for Date. Color shows details about Railroad. The data is filtered on Measure and Variable. The Measure filter keeps Speed. The Variable filter keeps All Trains. The view is filtered on Railroad and Date. The Railroad filter keeps CN and CP. The Date filter includes dates on or after 5/4/2010.

*Courtesy ASI-Transmatch*